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IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

BELLSOUTH TELECOMMUNICATIONS, INC., *et al.*,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

REPLY BRIEF FOR PETITIONERS

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TABLE OF AUTHORITIES

Cases:

AT&T v. FCC, 836 F.2d 1386 (D.C. Cir. 1988) 8

Dayton-Goose Creek Ry. v. United States, 263 U.S. 456 (1924) 5, 6

Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) 6

FPC v. Natural Gas Pipeline Co., 315 U.S. 575 (1942) 6, 7

FPC v. Tennessee Gas Transmission Co., 371 U.S. 145 (1962) 4

Louisville & N. R.R. v. Sloss-Sheffield Steel & Iron Co., 269 U.S. 217 (1925) 7

MCI Telecommunications Corp. v. AT&T, 114 S. Ct. 2223 (1994) 8

Meeker v. Lehigh Valley R.R., 236 U.S. 412 (1915) 7

Nader v. FCC, 520 F.2d 182 (D.C. Cir. 1975) 5

New England Tel. & Tel. Co. v. FCC, 826 F.2d 1101 (D.C. Cir. 1987), *cert. denied*, 490 U.S. 1039 (1989) 8

Ohio Bell Tel. Co. v. FCC, 949 F.2d 864 (6th Cir. 1991) 9

Public Serv. Comm'n v. Chesapeake & Potomac Tel. Co., 5 F.C.C. Rcd 5518 (1990) 7

Reiter v. Cooper, 113 S. Ct. 1213 (1993) 7

Security Services, Inc. v. K Mart Corp., 114 S. Ct. 1702 (1994) 7

Virgin Islands Tel. Corp. v. FCC, 989 F.2d 1231 (D.C. Cir. 1993) 7, 9

Statutes:

Communications Act of 1934:

47 U.S.C. § 201(b) 4

47 U.S.C. § 205 . . . . . 2, 3

Natural Gas Act, 15 U.S.C. § 717, *et seq.* 4

Other Materials:

FCC, *Statistics of Common Carriers, 1994/1995 Edition* (Dec. 1995) 2

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REPLY BRIEF FOR PETITIONERS

The petition showed that the court of appeals departed from the requirements of the Communications Act by holding local telephone companies *per se* liable for retrospective damages solely because of their earnings, without regard to whether any specific rates were unjust or unreasonable, and without any determination of what a just and reasonable rate would have been.

Respondents first suggest that this error lacks continuing importance. Yet it will continue to affect more than a thousand telephone companies and nearly $2 billion in revenues every year. Respondents next disavow any conflict between the decisions of this Court and the holding below. They rest that conclusion, however, on a fundamental misreading of the relevant caselaw. Finally, respondents attempt to circumvent the command of Congress with arguments about supposedly "inequitable" outcomes. Those

arguments not only are unfounded from a policy perspective, but also have no proper place in this case about statutory construction.

1. Respondents contend that the question presented is "academic" because, as we explained in our petition, the very largest local exchange carriers are now subject to "price cap" regulation rather than rate-of-return regulation. Interexchange Carrier (IXC) Br. 6; U.S. Br. 12-13; *see* Pet. 12 n.7. Respondents note that only 10 percent of federally regulated local telephone revenues are now subject to rate-of-return restrictions. U.S. Br. 12-13; IXC Br. 6.

But they neglect to mention that this 10 percent of revenues amounts to about ***$1.6 billion per year***.[1] All but a dozen or two of the nation's approximately 1,350 local telephone companies remain subject to rate-of-return regulation and will therefore continue to bear significant after-the-fact damages exposure under the decision below. It is precisely these smaller carriers, moreover, whose limited resources make them least able to predict their rates of return and most vulnerable to serious financial dislocation from cumulative damages awards that drive their effective earnings below authorized levels. A ruling that inflicts an ongoing threat of damages liability on more than a thousand companies and that implicates services valued at nearly $2 billion annually can hardly be characterized as of "little continuing importance." U.S. Br. 13.[2]

2. Respondents defend the imposition of damages liability on petitioners under Section 205 of the Communications Act, 47 U.S.C. § 205, which requires common carriers to abide by the FCC's rate prescriptions. U.S. Br. 13-14; IXC Br. 7. That effort

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[1] The price-capped interstate revenues of the large "Tier 1" local carriers totaled $14.6 billion in 1994. FCC, *Statistics of Common Carriers, 1994/1995 Edition* 264 (Dec. 1995). If those revenues are about 90 percent of all local exchange carrier revenues, then rate-of-return regulated companies had revenues of about $1.6 billion.

[2] It is immaterial that carriers subject to a rate-of-return regime can convert to price cap regulation instead. *See* U.S. Br. 13. If the Commission wants to encourage local carriers to select price cap regulation, it may do so in a proper rulemaking consistent with the Communications Act, not by imposing unlawful liability upon recalcitrant companies.

shows how thoroughly respondents seek to rewrite the governing statute.

Section 205(b) allows the Commission to assess a forfeiture of up to $12,000 per offense upon a common carrier (or an officer or representative thereof) "who knowingly fails or neglects to obey any order made [by the FCC] under the provisions of [section 205]." 47 U.S.C. § 205(b). Congress thus established a specific penalty, to be paid into the federal treasury, for violations of Commission rate orders such as the rate-of-return prescriptions at issue in this case.

The Commission did not here assess public forfeitures under Section 205. Instead, it awarded long-distance carriers private damages totaling more than $83 million plus interest. The Commission (and the court of appeals) relied exclusively on the theory that petitioners were subject to *per se* damages liability under Section 206 because they charged unreasonable rates in violation of Section 201(b) of the Communications Act. Pet. App. 11a-13a. At no point was it ever suggested that petitioners were subject to damages liability because they violated Section 205. *See* Pet. App. at 5a (noting complainants' reliance on §§ 206-209); *id.* at 38a-39a (same).[3]

Respondents' effort to conflate Sections 205 and 206 ignores the language and structure of the Communications Act. As we explained in the petition (at 12-14), Section 206 allows damages only when a carrier "shall do, or cause or permit to be done, any act, matter, or thing *in this chapter* prohibited or declared to be unlawful, or shall omit to do any act, matter, or thing *in this chapter* required to be done." (Emphasis added.) Under respondents' embellishment of that provision, damages could *also* be awarded if a carrier does or omits to do something prohibited or required *by FCC order*. Neither the FCC nor the court of appeals is free to rewrite the statute enacted by Congress. Throughout the Communications Act, Congress attached different consequences to violations of the Act and violations of FCC orders. *See* Pet. 13

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[3] The record would not have supported assessment of penalties under Section 205(b), for the Commission never found—and could not have found—that petitioners knowingly exceeded the Commission's rate-of-return ceiling.

n.8. If these remedial distinctions were ignored, every FCC order, no matter how inconsequential, could be transformed into a provision of the Communications Act for enforcement purposes, including (as here) the imposition of private damages awards to individual carriers.

3. The petition demonstrated that, under the plain language of Section 201(b) and the decisions of this Court and lower courts, the Commission may not impose retrospective liability for an alleged violation of Section 201(b) unless it directly finds that the carrier's "charges"—that is, its rates—were "unjust or unreasonable." 47 U.S.C. § 201(b). Respondents contend that such a finding is implicit whenever a carrier earns more than the authorized percentage rate of return for a group of services. According to the Solicitor General, for example, "the only way that the carriers can realize earnings above the rate of return prescription is by charging rates that are unjust and unreasonable, and that therefore violate Section 201(b)." U.S. Br. 15.

To support their blanket presumption, respondents rely principally on a snippet from *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962), a case decided under the Natural Gas Act.[4] U.S. Br. 16; IXC Br. 8. *Tennessee Gas* involved an administrative order directing the gas company to refund monies received pursuant to rates that were designed to earn a return of 7%, rather than the 6⅛% that the Federal Power Commission found just and reasonable. *See* 371 U.S. at 147-49. In this context, the Court said:

> The Commission has found that the revised over-all rate schedule should have been calculated on a rate of return of 6⅛% rather than 7%. As a result the over-all rate was to that extent unlawful and refunds were due across the board to all customers in the Tennessee Gas system.

Id. at 153.

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[4] The Natural Gas Act, 15 U.S.C. § 717, *et seq.*, is one of several federal statutes that establishes a rate-making scheme similar to that of the Communications Act, and the construction of which is implicated by the D.C. Circuit's decision in this case. *See* Pet. 3 n.3.

Tennessee Gas thus stands for the narrow proposition—not germane to the issue here—that a rate *designed* to achieve an excessive return is unlawful for that reason. That rule has been applied under the Communications Act for more than 20 years. *See Nader v. FCC*, 520 F.2d 182 (D.C. Cir. 1975) (upholding order invalidating AT&T tariffs that had been designed to recover 9.5% return, after FCC found that 8.5% return was just and reasonable). *Tennessee Gas* does not at all support the unprecedented holding in this case, which exposes carriers to liability even though they reasonably design their rates to recover precisely the authorized rate of return.

The petition showed that under *Dayton-Goose Creek Ry. v. United States*, 263 U.S. 456 (1924), customers do not necessarily suffer injury—the prerequisite for recovery under Section 206—just because the carrier earns more than the regulatory maximum. Pet. 15-16. The Solicitor General argues that this holding is "inapposite" because, in *Dayton-Goose Creek Ry.*, a portion of the carrier's excessive returns was put into a revolving fund that benefited shippers. U.S. Br. 17-18 n.13.[5] The rule of *Dayton-Goose Creek Ry.*, however, does not turn upon the use to which the surplus earnings were put. The Court held that shippers had no interest in the monies they paid out to railroads because the rates were "reasonable from the standpoint of the shipper" even though they furnished more than a fair return to the railroad. 263 U.S. at 484. Overearnings could thus be taken "for public uses." *Id.* It was not required that those uses benefit shippers; indeed, half of the railroads' overearnings were allotted to the railroads themselves. *Id.* at 476-77.

The Solicitor General also invokes the Court's statement in *Dayton-Goose Creek Ry.* that "[i]f the profit is excessive, the sum of the rates is so." U.S. Br. 17 (quoting 263 U.S. at 483). But that sentence does not support his view that every rate is unlawful

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[5] For their part, the interexchange carriers seek to dismiss all prior caselaw with the breezy observation that none of the cases discussed in the petition "address the scope of a common carrier's liability in a private damages action for a conceded violation of a rate of return prescription." IXC Br. 5. Respondents are right that there is no precedent anywhere for the cause of action recognized below, but that hardly strengthens their position.

whenever a carrier earns an excessive overall rate of return. In fact, the Court was not considering particular rates at all. It was making the point that carriers are "not entitled as of constitutional right to more than a fair net operating income" from all regulated activities, regardless of the lawfulness of particular rates. 263 U.S. at 481; *see generally Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-10 (1989). In that context, the Court rejected (in the passage quoted by the Solicitor General) the idea "that the net operating profit accruing from a whole rate structure is not relevant evidence in determining whether *the sum of the rates* is fair." 263 U.S. at 483 (emphasis added). The Court specifically noted that it was considering "the general level of rates," *not* "the reasonableness of a particular rate or class of rates." *Id.* at 480. The issue presented in our petition, by contrast, is whether *particular* rates can be found unlawful based only on carrier earnings for a large group of separately priced services.

Respondents' attempt to distinguish *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942), is equally unavailing. That case involved a decision of the FPC finding a gas supplier's earnings excessive, but leaving it to the supplier to determine which of its rates should be adjusted prospectively to bring earnings down to the regulatory maximum. The Court did not suggest that all the supplier's rates were unlawful; on the contrary, it recognized that setting a rate of return and establishing rates are "two steps of different character," and that the existence of overearnings does not necessarily mean that any particular rate is excessive. *Id.* at 584.

The Solicitor General notes that, in *Natural Gas Pipeline*, the FPC and the Court assumed that at least one rate would have to be adjusted prospectively to cure the supplier's excessive earnings. U.S. Br. 18. It is a big step, however, from the assumption in *Natural Gas Pipeline* that overearnings must be cured by changing some *future* rate in some way, to the holding in this case that customers are entitled to damages because *every* rate charged was excessive by at least the percentage of the carrier's overearnings. The whole point of the *Natural Gas Pipeline* case, after all, is that regulators may leave corrective rate revisions to the supplier

because excessive earnings do *not* establish the proper rate level. 315 U.S. at 583-85.

In that regard, the Solicitor General dismisses as "dicta" the D.C. Circuit's statement that a variety of factors—such as whether the carrier's revenue projections were reasonable when made—must be considered before a rate may be judged unreasonable and a refund may be awarded under Section 204 of the Communications Act. U.S. Br. 19 (discussing *Virgin Islands Tel. Corp. v. FCC*, 989 F.2d 1231, 1239-40 (D.C. Cir. 1993)). Yet the D.C. Circuit took this principle directly from the FCC's own rulings. Pet. 17. Those administrative decisions involved the same question at issue here—whether rates are just and reasonable under Section 201(b). *See, e.g., Public Serv. Comm'n v. Chesapeake & Potomac Tel. Co.*, 5 FCC Rcd 5518, 5519 (1990) (rate not unlawful under § 201(b) where carrier faced "unique forecasting difficulties"). It makes no difference that the substantive Section 201 inquiry took place in an action for refunds under Section 204 rather than for damages under Section 206, for the Commission's remedial discretion under Section 204 becomes relevant only after unlawful rates have been found.

4. Respondents do not dispute that the *per se* liability imposed in this case conflicts with cases decided under the Interstate Commerce Act (ICA), which hold that regulators must determine what rate would have been reasonable before they may award damages for excessive rates. *See Security Services, Inc. v. K Mart Corp.*, 114 S. Ct. 1702, 1709-10 (1994); *Reiter v. Cooper*, 113 S. Ct. 1213, 1217 (1993); *Meeker v. Lehigh Valley R.R.*, 236 U.S. 412, 428 (1915).[6] The interexchange carriers totally ignore these cases,[7] while the Solicitor General suggests that ICA precedent can

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[6] As the court of appeals recognized, cases interpreting the damages provisions of the ICA provide "guidance in interpreting the Communications Act." Pet. App. 22a.

[7] They do, however, cite another case, *Louisville & N. R.R. v. Sloss-Sheffield Steel & Iron Co.*, 269 U.S. 217 (1925), that states the same proposition. *Id.* at 235 (shipper "damaged to the extent of the difference between the charges paid and those that would have accrued *at the rates found reasonable*") (emphasis added); *see* IXC Br. 11.

be put aside because "none of those cases involved a violation of a rate of return prescription." U.S. Br. 23.

The duty to honor statutory requirements does not depend upon whether an agency regulates rates directly or indirectly (by establishing maximum rates of return). As the Court held in *Meeker*, the ICA always "requires . . . a finding of the ultimate facts" before liability may be imposed on a carrier. 236 U.S. at 427. These facts include "what would have been a reasonable rate for the service" as well as "whether, if the rate was excessive and unreasonable, the [customer] was injured thereby, and, if so, the amount of his damages." *Id.* at 428. The FCC made none of these findings in holding petitioners liable to their customers.

5. In the end, respondents fall back on the argument that it would be "inequitable" to hold customers to their statutory burden of proving that a particular rate was unreasonable and what a reasonable rate would have been. This Court only recently made clear, however, that the FCC may not engage in a "fundamental revision of the statute" based on its assessment of "desirable policy." *MCI Telecommunications Corp. v. AT&T*, 114 S. Ct. 2223, 2232, 2233 (1994). It also is hard to see the fairness in subjecting carriers to retrospective damages liability even though they designed their rates to recover lawful profits, based on economic assumptions that were unassailable when made. *See* Pet. 20-23.

Specifically, respondents contend that the Commission's allowance of an earnings "buffer" and the possibility of adjusting rates during the two-year monitoring period give telephone companies sufficient opportunity to avoid damages liability. U.S. Br. 20; IXC Br. 10 & n.7. The D.C. Circuit has itself rejected that claim. Carriers, the court of appeals explained, "consistently deviat[e] from the authorized return by far more than the buffer amount" because there is not enough flexibility in the Commission's rules for "careful carrier[s]" to be sure of staying within the buffer zone. *AT&T v. FCC*, 836 F.2d 1386, 1390 n.4 (D.C. Cir. 1988); *see New England Tel. & Tel. Co. v. FCC*, 826 F.2d 1101, 1114 (D.C. Cir. 1987) (Buckley, J., dissenting)

(overearnings are "a central feature of rate-of-return regulation"), *cert. denied*, 490 U.S. 1039 (1989).[8]

Respondents also say that it would be unfair to require parties seeking damages under Section 206 "to establish a precise 'reasonable' rate" as an element of their case, when the carrier itself could not determine in advance what rates would recover the authorized level of earnings. U.S. Br. 23; *see also* IXC Br. 10-11. They further argue that it would be impossible to establish a "*single* set of potential just and reasonable rates, for there are any number of combinations of rates" that would have produced earnings below the authorized rate of return. IXC Br. 11.

Respondents make our point. Carriers cannot be sure at the outset that their rates will earn the expected level of revenues. Even after the fact, one cannot determine whether a particular rate was unreasonable by looking only at the carrier's earnings. That determination must be made by looking at all relevant factors, including the reasonableness of the carrier's cost and demand projections. *Virgin Islands Tel. Corp.*, 989 F.2d at 1239-40. Otherwise, carriers that scrupulously comply with their rate-making obligations under the Communications Act can be subjected to unforeseeable and largely uncontrollable retrospective damages liability that Congress never intended.

Throughout their briefs, respondents proceed from the assumption that if a carrier earns too much, customers are entitled to recover past payments. There is no historical basis for this claim of entitlement: When otherwise lawful rates produce excessive earnings, the standard remedy (not at all challenged here) has been to reduce future earnings through prospective rate adjustments. Carriers have not been held retrospectively liable. *See Ohio Bell Tel. Co. v. FCC*, 949 F.2d 864, 867 (6th Cir. 1991). There also is no logical reason why customers should recover damages from

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[8] Furthermore, the FCC awarded damages if a carrier's earnings in any *category* of its services exceeded the level prescribed for all its services in the aggregate. As a consequence, some carriers were required to pay damages even though their overall earnings were actually *below* the authorized ceiling. For example, the FCC ordered U S WEST to pay substantial damages for 1985-1986 even though it earned less than the FCC-prescribed 12.75% return in its overall operations. *See* Ct. App. J.A. at 388.

a carrier that acted blamelessly in setting its rates, but that operated more efficiently than expected or sold more of its services than projected. The decision below therefore is no more defensible as a matter of history or logic than as a matter of statutory construction.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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